TESTIMONY OF
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BEFORE THE
HOUSE COMMITTEE ON THE BUDGET

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Chairman Ryan, Ranking Member Van Hollen, and Members of the Committee, thank you for inviting me to testify this morning about the President's Fiscal Year 2012 Budget.

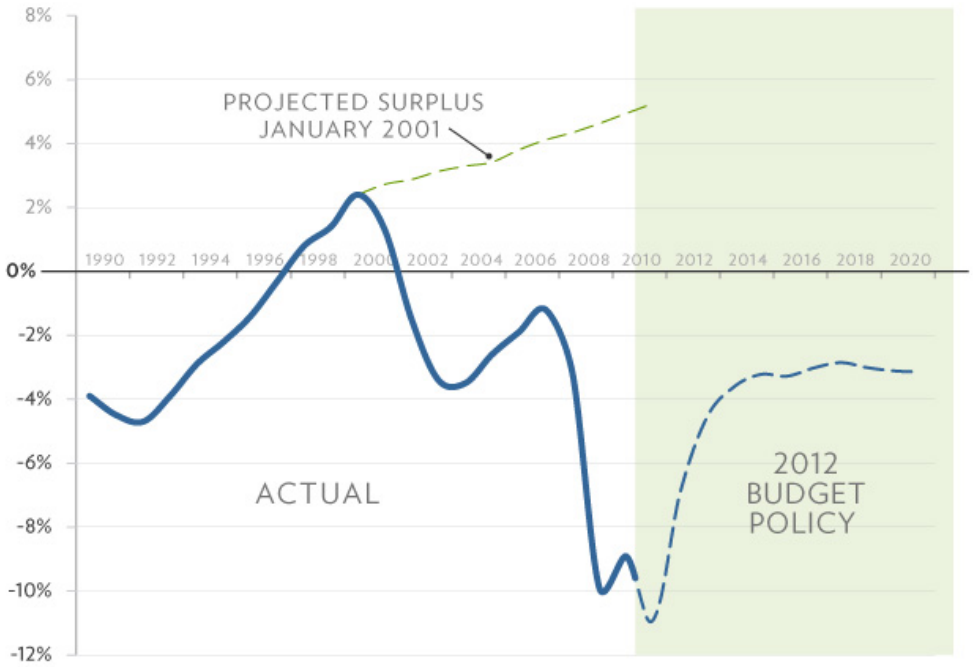
As the President has said, now that the country is back from the brink of a potential economic collapse, our goal is to win the future by out-educating, out-building and out-innovating our competitors so that we can return to robust economic and job growth. But to make room for the investments we need to foster growth, we have to cut what we cannot afford. We have to reduce the burden placed on our economy by years of deficits and debt.

This is the seventh budget I have worked on at OMB and the most difficult. It is a budget of shared sacrifice across the Federal government. It is a budget that makes tough choices to begin to tackle our major fiscal challenges. It is a budget that transitions from rescuing the economy to investing in our future. It is a budget that lives within our means in order to compete effectively in the world economy.

THEN AND NOW

The world has changed since I last served at OMB. When I left OMB in January 2001, we had balanced the budget and projected a surplus of $5.6 trillion over the next decade. In fact, we projected that the U.S. would effectively be debt-free by 2013. Unprecedented economic growth was certainly a key driver of budget surpluses. But in a virtuous cycle, a commitment by the President and the Congress to maintain a surplus reinforced expectation of Federal fiscal responsibility, which had a positive impact on interest rates and further helped to spur economic growth. This surplus was the result of year after year of fiscal discipline including budget agreements in 1990, 1993 and 1997. Presidents and congressional majorities from both parties reached across the aisle to make tough policy choices.

When I returned as OMB Director last November to a projected deficit of $10.4 trillion—a sixteen trillion dollar swing in just over ten years—the fiscal picture could not have been more different. Large deficits were driven by two main factors: first, the worst economic downturn in a generation and policy response necessary to rescue the economy, and second, the decision in prior years to give two large tax cuts without offsetting them and to create a Medicare prescription drug benefit without paying for it.



Clearly, the challenges we face today are very different than those we faced more than a decade ago, when many of us worked together to balance the budget.

OUR RECORD

Bringing the Economy Back from the Brink

It is useful to begin by reviewing the state of our economy, because it shows how far we have come but also how far we need to go.

When the President took office the economy was in freefall. Real gross domestic product (GDP) was dropping at an annual rate of 4.9 percent after falling at an annual rate of 6.8 percent the previous quarter. The economy was losing an average of 783,000 private sector jobs per month. A steep decline in the stock market combined with falling home prices led to a significant loss of household wealth. Between the third quarter of 2007 and the first quarter of 2009, the real net worth of American households declined by 28 percent – the equivalent of one year's GDP.

In the last year, we have seen some encouraging signs that the trajectory has changed and that a recovery is beginning to take hold. An economy that had been shrinking for nearly a year is now growing again—over the past six quarters, through the first quarter of FY 2011, real GDP has

grown at an average rate of 3.2 percent. After nearly two years of job losses, more than one million private sector jobs were added to the economy in 2010. Capital and credit markets are functioning and gaining strength. And after teetering on the brink of liquidation just two years ago, America's auto industry is posting healthy gains and returning money to the taxpayers who helped it through a period of turmoil.

What changed?

Just 28 days after taking office, the President signed into law the Recovery Act to create and save jobs and to invest in an economy able to compete in the 21st century. Approximately one-third, or $288 billion, of the Act's funds went to tax cuts for small businesses and 95 percent of working families. Another third, or $224 billion, was used for emergency relief for individuals and state and local governments. The final third was invested in projects to create jobs, spur economic activity, and lay the foundation for future sustained growth.

This investment had a powerful impact. The White House Council of Economic Advisers (CEA) estimates that the Recovery Act raised the level of GDP as of the third quarter of 2010 by 2.7 percentage points, relative to what it would have been absent intervention, and raised employment relative to what it otherwise would have been by between 2.7 and 3.7 million jobs in the same time frame.

And we have acted together to build on this growth. In March 2010, the President signed the Hiring Incentives to Restore Employment (HIRE) Act that provided subsidies for firms that hired workers who were unemployed for at least two months and other job creation incentives. In August, he signed into law $10 billion in additional aid to States to prevent the dismissal of 160,000 of teachers, police officers, and firefighters nationwide. In September, the President signed the Small Business Jobs Act. At the end of 2010, the President signed into law a bipartisan agreement on taxes that prevented a tax increase for middle-class families, extended unemployment insurance benefits for millions of Americans hardest hit by the recession, provided powerful incentives for business investment and job creation, and temporarily reduced the payroll tax which also would help spur macroeconomic demand. Economists from across the political spectrum agree that this bill will boost economic growth in 2011 by 0.5 to 1.2 percentage points.

From the Recovery Act to our financial stabilization plan, the President's tough choices over the past two years have helped to save the economy from a second Great Depression. But we are keenly aware that the recovery is not happening fast enough for the millions of Americans who are still looking for jobs, and our immediate task is to accelerate economic growth and job creation to get our fellow Americans back to work. That is why the President has proposed an up-front investment of $50 billion in building new roads, rails, and runways to upgrade our infrastructure and create new jobs. It is why the President is making key investments in innovation, clean energy, and education that will create jobs and make our workforce more competitive. And that is why the President laid out a commonsense approach to regulation that is pragmatic and evidence-based, and that will protect our health and safety and help lay the groundwork for economic growth and job creation.

Restoring a Sound Fiscal Policy

While taking steps to rescue the economy, the President has also worked to restore accountability and fiscal responsibility. In his first Budget, the President confronted directly the fiscal situation we inherited, eliminating trillions of dollars in budget gimmicks. He made a commitment to restoring fiscal responsibility, while recognizing that increasing the deficit in the short term was necessary to arrest the economic freefall. The President pledged to cut the deficit he inherited in half as a share of the economy by the end of his first term, a commitment this Budget keeps. He signed into law pay-as-you-go (PAYGO) legislation that returned the tough budget rules of the 1990s to Washington. The principle behind PAYGO is simple: all new, non-emergency entitlement spending and revenue losses must be offset by savings or revenue increases, with no exception for new tax cuts.

In addition, the President signed into law the landmark Affordable Care Act (ACA), enacting comprehensive health insurance reforms that will hold insurance companies more accountable, lower health care costs, guarantee more health care choices, and enhance the quality of health care for all Americans while reducing the deficit. According to CBO analysis, the Affordable Care Act will save more than $200 billion over the next ten years and will reduce the deficit by more than $1 trillion over the second decade. This is more deficit reduction than in any legislation since the 1990s. At the same time, the ACA's savings provisions tackle the single biggest contributor of our nation's long-term deficits—rising health care costs.

While taking major steps to bring down our deficits, the President also demanded that the Government spend every taxpayer dollar with as much care as taxpayers spend their own dollars. The President proposed legislation to create an expedited rescission authority so that unnecessary spending can be struck swiftly and constitutionally. Through his Accountable Government Initiative, the Administration has launched a host of initiatives to streamline what works, cut what does not, and eliminate wasteful spending. These initiatives include focusing agencies on identifying and delivering on their top priorities, a comprehensive strategy to reform Government contracting that will save $40 billion by the end of 2011, an initiative to reduce the amount of improper payments made by the Government by $50 billion, a review and reform of information technology use and procurement, an initiative to reduce administrative overhead by billions and improve performance, and an effort to dispose of billions of dollars of unneeded and under-utilized real property assets.

Each year since entering office, President has asked his Administration to go line-by-line through the Budget to identify programs that are outdated, ineffective, or duplicative. In his first two Budgets, the President identified more than 120 terminations, reductions, and savings, totaling approximately $20 billion in each year. These terminations ranged from a radio navigation system for ships made obsolete by GPS to new F-22 fighter jets. While recent administrations have seen between 15 and 20 percent of their proposed discretionary cuts approved by the Congress, the Administration saw 60 percent of its proposed discretionary cuts become law for 2010.

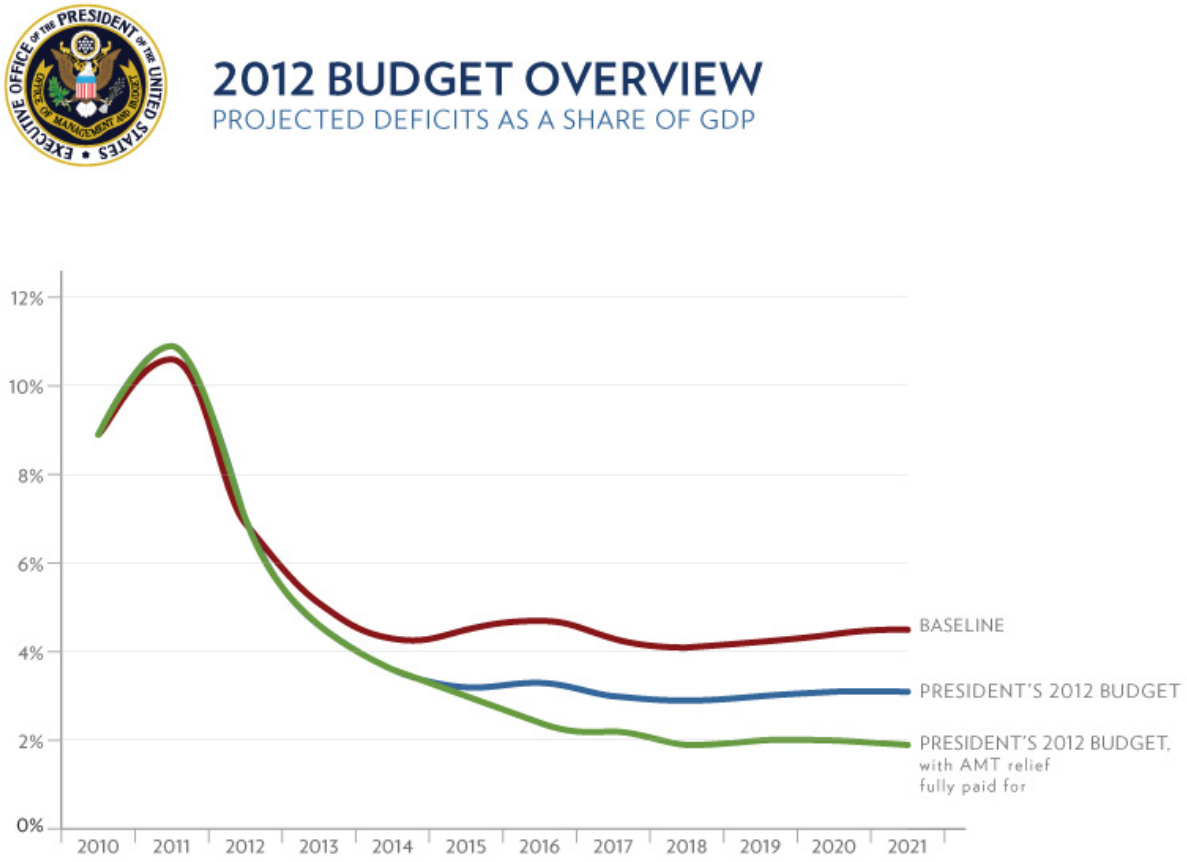
Finally, in April 2010, the President created the bipartisan National Commission on Fiscal Responsibility and Reform, and charged the Commission with identifying policies to improve the fiscal situation in the medium term and to achieve long-term fiscal sustainability. The

Commission made an important contribution, beginning the process of building a bi-partisan consensus on the nature of the challenge we face and expanding the debate to include a broader range of options. While the Administration doesn't agree with every recommendation in the report, there are many areas of this budget that reflect the work of the Commission.

LIVING WITHIN OUR MEANS AND INVESTING IN THE FUTURE

Now that the country is back from the brink of a potential economic collapse, our goal is to win the future. But we cannot do so if we are saddled with increasingly growing deficits. This Budget builds on recent progress and lays out a comprehensive and responsible plan that will put us on a path toward fiscal sustainability for the rest of the decade—a down payment that will build a strong foundation to tackle our long-term challenges.

The projected deficit this year is nearly 11 percent of GDP, the highest level since World War II, reflecting the severity of the recession and our temporary measures to generate jobs and growth. The Budget lays out a path of rapid deficit reduction—the most deficit reduction in a comparable period since World War II. In the second half of the decade and beyond, debt is no longer growing as a share of GDP—a key indicator of fiscal sustainability. Redirecting our fiscal path on this downward slope is a significant accomplishment, one which will take tough choices and



shared sacrifice—and is essential for the long-term competitiveness of the American economy.

The first step to reducing our deficit is maintaining a strong economy, which is a key priority for the Budget. As the baseline projections show, with economic growth we begin to make substantial progress at reducing the deficit even before we make additional policy changes. However, even with a sustained recovery, simply continuing current policies does not get the job done – it would leave us with deficits of between 4 and 5 percent of GDP—with debt growing at an unsustainable rate through the end of the decade and beyond.

To stay on a path towards sustainable deficits on the order of 3 percent of GDP, we make tough choices across all areas of the Budget to identify more than $1 trillion in savings – two thirds from spending reductions. This requires decisions beyond just separating the good programs from the bad. It means broadly sharing sacrifices in all areas of the Budget in order to make critical investments in areas most important to growth and competitiveness. And it means reducing spending in areas where we continue believe there is still important work to do. It cannot be achieved by simply looking at discretionary spending – we need to look at mandatory and revenue policies as well. An overview of key decisions in the FY 2012 Budget is as follows:

- *Non-security discretionary*. The Budget proposes to freeze non-security discretionary spending for five years, which saves more than $400 billion over the next decade and brings this category of spending to its lowest level as a share of the economy since Dwight Eisenhower was in office.

- *Security discretionary*. The Budget reflects tough decisions in areas outside of the non-security freeze—bringing Defense spending down from a long period of significant real growth to zero real growth, saving $78 billion over the next five years relative to last year's plan. Reflecting the winding down of military operations in Iraq, the Overseas Contingency Operations (OCO) budget for DOD in 2012 will be about 26 percent lower than levels in the President's 2011 request. As a result, the overall defense budget, including OCO, will be down by 5.2 percent from last year's request.

- *Health care*. The Budget fully pays for a two-year extension of current Medicare physician payment rates with $62 billion in health care savings, preventing a payment cut of over 25 percent. The Budget also proposes incentives for States to implement medical malpractice reforms to further reduce the growth of health care costs.

- *Revenues*. The Budget pays for three years of AMT relief by cutting the value of tax expenditures for high-income taxpayers by 30 percent. The Budget also opposes any further extension of the unaffordable upper-income tax cuts to two years.

- *Fiscal stewardship*. The Budget includes several proposals to reduce the risk of future liabilities. These include giving the Pension Benefit Guaranty Corporation (PBGC) the ability to adjust premiums to reflect all risks facing the pension insurance system and proposing reforms to encourage State responsibility and improve the solvency of the Unemployment Insurance Trust Fund.

SHARED SACRIFICES, HARD CHOICES

To be competitive in the 21st Century, the United States cannot be weighed down by crippling budget deficits, ineffective programs that waste tax dollars, and a government that is not accountable to the American people.

Five-year non-security freeze. It would be short-sighted to cut spending across the board and shortchange critical areas for growth and competitiveness – such as education, innovation, and infrastructure – or carelessly slash programs that protect the most vulnerable. This means that some cuts must be deeper to make room for key investments. In his 2011 Budget request, the President proposed a three-year, non-security discretionary freeze. As the economic recovery takes hold, the President believes that it is important to go further and is now proposing a five-year, non-security discretionary freeze. This is an extension of the freeze proposed last year, based on 2010 enacted levels. This freeze would be the most aggressive effort to restrain discretionary spending in 30 years and, by 2015, would lower non-security discretionary funding as a share of the economy to the lowest level since Dwight D. Eisenhower was president. Over the decade, the five-year freeze saves more than $400 billion.

Program terminations, reductions, and savings. In part to meet this freeze, the Budget includes over 200 terminations, reductions, and savings totaling more than $33 billion in savings for 2012 alone. On their own, these cuts will not solve our fiscal problems, but they are a critical step to creating a more responsible and accountable Government and a key component of a comprehensive deficit reduction strategy. It is never easy to end or cut programs; they all have advocates. Some programs are duplicative, outdated and ineffective. But we also had to choose programs that, absent the fiscal situation, we would not cut:

- **Low-Income Housing Energy Assistance Program (LIHEAP).** The Budget cuts LIHEAP by more than $2 billion, returning LIHEAP funding to 2008 levels, prior to the energy price spikes. However, in this difficult fiscal environment, we cannot afford to maintain the expansion to the program.

- **Community Services Block Grant (CSBG).** CSBG has helped to support community action organizations in cities and towns across the country. These are grassroots groups working in poor communities, dedicated to empowering those living there and helping them with some of life's basic necessities. These are the kinds of programs that President Obama worked with when he was a community organizer, so this cut is not easy for him. Yet for the past 30 years, these grants have been allocated to virtually the same organizations, using a formula that does not consider how good a job the recipients are doing. The Budget proposes to cut financing for this grant program in half, saving $350 million, and to reform the remaining half into a competitive grant program, so that funds are spent to give communities the most effective help.

- **Grants-in-Aid for Airports.** The Budget lowers funding for the airport grants program to $2.4 billion, a reduction of $1.1 billion, by eliminating guaranteed funding for large and medium hub airports. The Budget focuses the traditional Federal grants to support smaller commercial and general aviation airports that do not have access to additional

revenue or other outside sources of capital. At the same time, the Budget would allow larger airports greater flexibility to generate revenue with increased non-Federal passenger facility charges.

These cuts are not limited to a few agencies. Rather, these cuts reflect shared sacrifice across the Federal government—even for agencies that are central to out-competing, out-building, and out-educating in the 21st century. For example, the Department of Education has made difficult decisions in order to maintain historic increases for Pell Grants, which are critical to creating future generations that are well-educated and globally-competitive. The Administration would put Pell Grants on firm financial footing through steps that include eliminating the in-school interest subsidy for loans to graduate students and ending the new year-round Pell Grant, which offers students a second Pell Grant in one year, but has cost ten times more than anticipated. The Budget also eliminates 13 discretionary programs at the Department of Education and consolidates 38 K-12 programs into 11 new programs that emphasize using competition to allocate funds.

Federal civilian employee pay freeze. Federal workers are patriots who work for the Nation often at great personal sacrifice. They deserve our respect and gratitude. But just as families and businesses across the country are tightening their belts, so too must the Federal government. On his first day in office, the President froze salaries for all senior political appointees at the White House. In his Budget last year, the President proposed extending that freeze to other political appointees, and he eliminated bonuses for all political appointees across the Administration. Starting in 2011, the President has proposed and Congress enacted a two-year pay freeze for all civilian Federal workers. This will save $2 billion over the remainder of 2011, $28 billion over the next five years, and more than $60 billion over the next 10 years.

Savings in discretionary security programs. The President's Budget also demands cuts and savings in security programs. DOD, in particular, has seen an average increase to its base budget of 7.4 percent a year over the past decade. Moving forward, DOD is pursuing a variety of strategies to set the course for zero real growth in defense spending, and saving $78 billion in its base budget (including $13 billion in FY 2012) relative to FY 2011's request for the next five years. Secretary Gates will oversee a package of terminations, consolidations, and efficiencies in operations to slow this growth, and these savings will be used to fund programs and efforts critical to the armed forces and the security of the Nation. Reflecting the winding down of military operations in Iraq, the Overseas Contingency Operations (OCO) budget for DOD in 2012 will be about 26 percent lower than levels in the President's FY 2011's request. As a result, the overall defense budget, including OCO, will be down by 5.2 percent from last year's request.

Administrative savings. Allowing waste is never right, and it is especially intolerable in a time of tightening belts and tough decisions. Continuing the President's Accountable Government Initiative, the Budget cuts $2 billion in administrative overhead like travel, printing, supplies, and advisory contract services; establishes a process to quickly sell excess and under-utilized Federal real estate; and embraces competitive grant programs based on the Race to the Top model. This model is applied to programs from early childhood education through college; to

allocate grants for transportation; to bring innovation to workforce training; and to encourage both commercial building efficiency and electric vehicle deployment.

Reorganize government. We live and do business in a global economy, but the organization of our government has not kept pace with the private sector advancements of the 21st century. Many of our government organizations have strayed from their original or core missions, evolving out of inertia rather than in response to the changing needs of the groups they serve. This has resulted in duplicative and ineffective programs that persist and grow over time, and an organization of functions that doesn't always make sense. For example, as the President stated in his State of the Union address, there are twelve different agencies that deal with exports. Americans deserve a streamlined, efficient and well-functioning Federal government that is responsive to the needs of its citizens and of the private sector.

The Budget reflects the President's commitment to reorganizing the Federal government to ensure that our resources are being used effectively and efficiently, with a particular focus on making the U.S. more competitive. In the coming months we will be working to identify where we can merge, consolidate and cut in order to better facilitate the needs of all American companies, entrepreneurs, and innovators and give these engines of economic growth a leg up in the global economy. The President plans to submit a proposal to Congress to enact the changes necessary to reorganize the Federal government in a way that best serves the goal of a more competitive America.

INVESTMENTS IN OUR FUTURE

The best antidote to a growing deficit is a growing economy, which spurs expanded employment, higher revenue collection, and lower demand for spending on safety net programs like unemployment insurance nutrition assistance. Putting the Nation on a sustainable fiscal path and getting our deficits under control are critical to making the United States competitive in the global economy, and the Budget lays out a strategy to do this. At the same time, it also recognizes that we cannot cut back on investments that will fuel future economic growth particularly since sustained and robust economic growth plays a very significant, long-term role in reducing deficits. While the Budget identifies cuts and savings and asks for shared sacrifices across the government, it also invests in areas critical to helping America win the race for the jobs and industry of the future.

We must target scarce Federal resources to the areas critical to winning the future: education, innovation, clean energy, and infrastructure.

Educate a competitive future workforce. In an era where most new jobs will require some kind of higher education, we have to keep investing in the skills of our workers and the education of our children. This Budget continues to support the President's commitment to once again have the highest proportion of college graduates in the world by 2020, and continues the reform agenda not just by devoting significant resources to where they are needed, but also by ensuring

that those funds are being invested in programs that deliver results efficiently and effectively. This Budget calls for:

- Maintaining the Pell Grant maximum award at $5,550. Since 2008, the Administration has increased the maximum Pell Grant by $819, ensuring access to postsecondary education for over 9 million students from low-income families.

- Supporting reform of K-12 education with expanded Race to the Top and other innovative, evidence-based programs that encourage innovation and reward success, and expands the Race to the Top concept to early childhood education with $350 million to establish a new, competitive Early Learning Challenge Fund for States.

- Establishing a Workforce Innovation Fund that will encourage States and localities to break down barriers among programs, test new ideas, and replicate proven strategies for delivering better employment and education results at a lower cost per outcome.

Investment in R&D and transformational technologies. To compete in the 21st century economy, we need to create an environment where invention, innovation, and industry can flourish. That starts with continuing investment in the basic science and engineering research and technology development from which new products, new businesses, and even new industries are formed. We must focus in areas that show the greatest promise for job creation to position ourselves to get ahead of our competitors and be a leader in emerging industries. This Budget makes significant investments in clean energy technology and research and development to nurture the United States as a world leader in innovation. To meet these goals, the Budget calls for:

- Providing $148 billion for research and development. This level of funding continues the effort to double investments in basic research at the National Science Foundation, Department of Energy Office of Science, and the National Institute for Standards and Technology (NIST); provides robust investment in biomedical research at National Institutes of Health (NIH); and doubles energy efficiency research and development.

- Making the Research and Experimentation (R&E) tax credit permanent to give businesses the certainty they need to make these important investments. In addition, the Administration proposes to expand the credit by about 20 percent, the largest increase in the credit's history, and simplify it so that it is easier for firms to take this credit and make the investments our economy needs to compete.

- Bolstering economic rejuvenation in hard-hit areas of our country with new Growth Zone program. Growth Zones will deliver expanded tax incentives for investment and employment and a more streamlined access to government assistance to 20 new areas facing economic distress as well as growth potential.

- Providing $8.7 billion for clean energy technology research, development, demonstration, and deployment. This includes more than doubling energy efficiency investments and increasing renewable energy investments by over 70 percent. The Budget seeks to reinforce new approaches to energy research by adding three new energy innovation hubs

and expanding investment in the Advanced Research Projects Agency – Energy (ARPA-E). In addition, the budget provides $5 billion for Section 48C tax credits for renewable energy manufacturing facilities.

Build a 21st century infrastructure. To compete in the 21st century, we need an infrastructure that keeps pace with the times and outpaces our rivals, and for too long we have neglected our Nation's infrastructure, its roads, bridges, levees, waterways, communications networks, and transit systems. In the Recovery Act, the Administration made the largest one-time investment in our Nation's infrastructure since President Eisenhower called for the creation of a national highway system. We need to continue to build on those efforts –and to do so responsibly by paying for what we build. We cannot strengthen our economy with a modern infrastructure if at the same time it weakens our fiscal standing. To give America the world-class infrastructure our economy needs, the Budget:

- Proposes a six-year surface transportation reauthorization that increases average annual investment by $35 billion per year, in real terms, over the previous six year authorization plus passenger rail funding in those years; this represents a total inflation-adjusted increase of sixty percent over the life of the bill. To bring the trust fund under budget enforcement mechanisms, the Budget proposes to reclassify trust fund spending on surface transportation as mandatory, subjecting it to PAYGO rules and closing score-keeping loopholes.

- Provides $1.2 billion for the Next Generation Air Transportation System, the Federal Aviation Administration's multi-year effort to improve the efficiency, safety, and capacity of the aviation system.

- Invests in smart, energy-efficient, and reliable electricity delivery infrastructure. The Budget continues to support the modernization of the Nation's electrical grid by investing in research, development, and demonstration of smart-grid technologies to spur the transition to a smarter, more efficient, secure and reliable electrical system.

- Builds next-generation wireless broadband network to provide access to 98 percent of the population, creates a Wireless Innovation Fund, and establishes an interoperable broadband network for public safety. These proposals will be fully paid for with proceeds from proposed "voluntary incentive auctions" of underused spectrum and other spectrum management measures, which will generate more than $27 billion over the next decade. In addition to funding the programs above, nearly $10 billion of these proceeds will be dedicated to deficit reduction.

BUILDING ON OUR PROGRESS

Now that the recovery is beginning to take hold, taking further steps to ensure responsibility has to be a priority—not because fiscal austerity in and of itself is virtuous, but because there is no way that we can compete and win in the world economy if we are borrowing without an end in sight.

The President's Budget is a down payment. It puts the government on a path to reach sustainable deficits over the next ten years. This means that for the first time in 10 years, the government will again be fully paying for all of its programs and the debt will stabilize as a share of GDP. This is an important milestone—but not the finish line—on the path to a balanced budget.

We cannot achieve sustainable levels with ever deeper cuts in non-security discretionary spending, which is simply not a large enough share of the picture either to cause or to solve the whole problem. The President has been clear that we must work on a bipartisan basis to find long-term solutions across all areas of the Budget, including Medicare, Medicaid, and tax reform.

Continue efforts to restrain the growth of health costs. Health care comprises one-quarter of non-interest Federal spending, and it is the key driver of future deficit growth. According to CBO analysis, the Affordable Care Act will save more than $200 billion over the next ten years and will reduce the deficit by more than $1 trillion over the second decade. This is a pivotal achievement, and the President is resolutely committed to implementing the ACA fairly, efficiently, and swiftly. But the job is not yet done. The Budget builds on the ACA with additional proposals to contain health care cost growth:

- The ACA made important advances in the area of program integrity, but there are other important opportunities to reduce fraud, waste, and abuse in Medicare and Medicaid. The Budget includes ideas pulled from external sources, including recommendations from the President's Fiscal Commission and from legislation that has received bipartisan support. The $62 billion in health savings in the Budget focus on increasing program integrity, efficiency, and accountability—not reducing beneficiary access or benefits. For example, the Budget extends efficiencies from Medicare competitive bidding for durable medical equipment to Medicaid, and prohibits brand and generic drug companies from delaying the availability of new generic drugs ("pay-for-delay").

- At the same time, these health savings pay for two years of relief from the Sustainable Growth Rate (SGR) formula—preventing a decrease of nearly 30 percent in physician payments that would hurt Medicare. This paid-for extension is on top of the three previous paid-for extensions of the SGR fix, including the one-year extension enacted in December, establishing a pattern of practice that we hope to continue as we work with Congress to achieve a permanent fix.

- Fully implementing the Affordable Care Act achieves cost savings and promotes efficient care, including reimbursing doctors and hospitals as Accountable Care Organizations, and adjusting payments to hospitals with high readmissions or hospital-acquired conditions. Implementing the Act also has the potential to fundamentally transform our health system into one that delivers better care at lower cost—a potential that is not fully captured in the ACA savings estimates. In particular, the Act incorporates the most promising ideas from economists and leaders from across the political spectrum to control health care costs.

- The President's Budget includes $250 million in grants to States to reform their laws on medical malpractice through various approaches such as health courts, safe harbors, early

disclosure and offer programs, or other legal reforms. These grants would be awarded and administered by the Bureau of Justice Assistance (BJA) in consultation with the Department of Health and Human Services. The goal of any reform would be to fairly compensate patients who are harmed by negligence, reduce providers' insurance premiums, weed out frivolous lawsuits, improve the quality of health care, and reduce medical costs associated with "defensive medicine." This proposal is in line with the Fiscal commission's recommendation for "an aggressive set of reforms to the tort system."

Make a Down Payment on Tax Reform. To foster a competitive economy, we must have sensible and affordable tax policy that is consistent with our overall objectives of deficit reduction and economic growth. Since the last comprehensive overhaul nearly three decades ago, the tax code has been weighed down with revenue-side spending in the form of special deductions, credits, and other tax expenditures that do little for middle income families, and burdened with generous upper income tax cuts and more generous estate tax cuts for families making more than $250,000 a year. To compete and win in the world economy, we cannot sustain a tax code burdened with these unaffordable benefits. This is why the President has called on the Congress to undertake a fundamental reform of our tax system. As progress towards this goal, the Budget calls for:

- Allowing the 2001 and 2003 High-Income and Estate Tax Cuts to Expire. The Administration remains opposed to the permanent extension of these high-income tax cuts past 2012, as now scheduled, and supports the return of estate tax to 2009 rates and exemption levels. These policies save nearly a trillion dollars over the decade including interest effects. We cannot afford these unpaid-for tax breaks for the wealthiest Americans and we are committed to limiting the current extension to two years.

- Beginning the Process of Corporate Tax Reform. The United States has the highest corporate tax rate in the world. Part of the reason for this is the proliferation of tax breaks and loopholes written to benefit a particular company or industry. The result is a tax code that makes our businesses and our economy less competitive as a whole. The President is calling on Congress to work with the Administration on corporate tax reform that would simplify the system, eliminate these special interest loopholes, level the playing field, and use the savings to lower the corporate tax rate for the first time in 25 years -- and do so without adding a dime to our deficit.

- Paying for the Alternative Minimum Tax (AMT). This Budget provides for a three year extension of AMT relief, and is offset by an across-the-board 30 percent reduction in itemized deductions for high-income taxpayers. This is the first time an extension of AMT relief has been fully paid for. While our base projections do not assume that we continue to pay for AMT relief after 2014, the President is committed to working with Congress to fully pay for AMT relief beyond this window. Doing so reduces the deficit by an additional 1 percent of GDP by the end of the decade relative to the deficit reduction in the Budget.

Take Steps Now to Reduce Future Liabilities. Looming debts and unfunded liabilities can put taxpayers on the line for bailing out programs in the future. The Budget promotes fiscal stewardship by restoring responsibility to key areas. First, the Budget proposes to give the Pension Benefit Guaranty Corporation (PBGC) Board the ability to adjust premiums and directs PBGC to take into account the risks that different sponsors pose to their retirees and to PBGC. This will both encourage companies to fully fund their pension benefits and give the PBGC the tools to improve its financial soundness without over-burdening the companies it ensures, saving $16 billion over next decade. Second, the 2012 Budget provides short-term relief to States by providing a two-year suspension of State interest payments on their debt and automatic increases in Federal unemployment insurance (UI) taxes. At the same time, the Budget proposes steps to encourage States to put their UI systems on firmer financial footing and pay back what they owe to the Federal government. Beginning in 2014, the Budget increases the minimum wages states can subject to unemployment taxes to $15,000. Finally, the Budget proposes to gradually reduce the loan portfolios and eligible loan sizes of Fannie Mae and Freddie Mac and end the conservatorship of these companies, scaling back government support in a way that allows private capital to return without undermining the housing market recovery.

Begin a Dialogue on Social Security Solvency. The President considers Social Security to be one of our most successful programs, and indispensable to workers, people with disabilities, seniors, and survivors. The President has been clear that we need to strengthen Social Security to make sure that Social Security is sound and reliable for the American people, now and in the future. The Budget lays out the President's principles: Reform should strengthen the program and its protections for the most vulnerable, without putting at risk current retirees and people with disabilities, without slashing benefits for future generations, and without subjecting American's guaranteed retirement income to the whims of the stock market. The President believes that the best way forward is for leaders of both parties to come together to discuss the way forward on a bipartisan basis.

Social Security is not contributing to our deficit any time soon. Our goal is to make sure that current and future generations are assured that the system will remain sound for the long term as well – to provide the peace of mind that is one of the important benefits of insurance.

A WAY FORWARD

There has been a vibrant national conversation on fiscal responsibility over the past several months. The President's Fiscal Commission made important progress in launching a serious bipartisan discussion last year, and I commend them for resetting the debate on further deficit reduction. While the President has not embraced all of their proposals, many of them are included in this year's Budget. Federal employee pay freezes, medical malpractice reform, a call for government reorganization, and the elimination of in-school subsidies for graduate student loans are just a few examples. Our Terminations, Reductions, and Savings volume includes numerous proposals that were also recommended for termination or reduction by the Fiscal Commission. And like the Commission, we make proposals to improve budget discipline, including subjecting the Transportation Trust Fund to PAYGO rules and providing for program integrity cap adjustments. We must take serious steps to both cut spending and cut deficits. We

must address these issues in a bipartisan way. And we must do so in a way that is consistent with our core values.

The Fiscal Commission was clear that that the only way to tackle our deficit is to cut excessive spending wherever we find it – in domestic spending, defense spending, health care spending, and spending through tax breaks and loopholes. Now that the worst of the recession is over, we have to confront the fact that our government spends more than it takes in. That is not sustainable and we need a comprehensive approach

The five year non-security freeze achieves significant savings with a dramatic reduction in discretionary spending over the coming decade, and it will require commitment from both the Administration and Congress to live within that framework. But we have to remember that this category of spending represents a little more than 12 percent of our Budget. To make further progress, we cannot pretend that cutting this kind of spending alone will be enough. Looking forward, we will have to make hard decisions to further reduce health care costs, including programs like Medicare and Medicaid, which are the single biggest contributor to our long-term deficit. Health insurance reform will slow these rising costs, which is part of why nonpartisan economists have said that repealing the health care law would add a quarter of a trillion dollars to our deficit. Still, we need to look at other ideas to bring down costs, and the proposals in this year's Budget are a first step. And we cannot afford a permanent extension of the tax cuts for the wealthiest two percent of Americans if we are committed to achieving a sustainable deficit.

This Budget builds on the work of the last two years, and makes a down payment on a strong American future. Much work remains to be done. We need to take steps to reduce our future liabilities. And we need to work to shape our government into one that is more affordable, more effective, and more efficient.

I look forward to working with both houses of Congress in the coming months as we work to put our fiscal path back on a sustainable course.